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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 1000

THE PETTICREW REAL ESTATE COMPANY, Bankrupt,
Petitioner,

vs.

HARRY MUFFLER, as Receiver of the Petticrew Real Estate Company, the Merchants and Mechanics Federal Savings & Loan Association, and the Springfield Federal Savings & Loan Association,
Respondents.

BRIEF OF RESPONDENTS ON THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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To the Chief Justice and the Associate Justices, Honorable Justices of the Supreme Court of the United States of America:

In reply to the petition and brief of counsel for the petitioner herein for a writ of certiorari from this Honorable Court to the United States Circuit Court of Appeals for the Sixth Circuit to certify its record in cause No. 9264 before said Circuit Court of Appeals, these counsel for respondents respectfully beg leave to submit to this Honorable Court this brief:

THE FACTS

Because of the omission by petitioner of certain facts pertaining to the proceedings in the lower courts, respondents believe it advisable to set forth a complete chronological statement.

In 1933 an action was commenced in the Court of Common Pleas of Clark County, Ohio, a court of original and general jurisdiction, for the appointment of a receiver for the petitioner, The Petticrew Real Estate Company. One of the respondents, Harry Muffler, shortly after the action was instituted was appointed and qualified as a general receiver with authority to operate the business. (Record page 14, 15, 16)

The receivership has been in continuous operation since created. On February 16th, 1938, the receiver filed a petition in the proceedings for the sale of certain real estate, assets of the corporation, to which a number of additional parties including respondents, the Merchants and Mechanics Federal Savings and Loan Association and the Springfield Federal Savings and Loan Association, were made parties defendant. (Record page 17 et seq.) On June 18th, 1938, respondent Savings and Loan Associations intervened by cross-petition setting up mortgage liens asserted by them upon each of the various tracts of real estate described in the petition for authority to sell and praying the court for an order of foreclosure, adjudication of the amounts and priorities of their respective mortgage liens, marshalling of liens and other incidental relief. (Record page 42 et seq.)

Before a hearing was had by the court upon the issues, March 1st, 1939, The Petticrew Real Estate Company filed

a petition under Chapter Ten of the Bankruptcy Act (The Chandler Act) in the District Court of the United States for the Southern District of Ohio for a reorganization. During the pendency of this proceeding the proceedings in the Court of Common Pleas were enjoined and the assets of the petitioner placed in the custody of a trustee appointed by the District Court where they remained until May 22nd, 1941 when an order was entered by the District dismissing the petition for reorganization and remanding the assets of the corporation to the receiver and Court of Common Pleas. (Record page 168, 169)

On March 16th, 1942, after a trial by the Court of Common Pleas, the court ordered that unless certain specific amounts found due on each of the respective mortgage liens upon the various tracts of real estate were paid within a date fixed by the court, that an order of sale should issue and the various mortgages be foreclosed.

The court also found that the real estate constituted the greater portion of the assets and that the receiver should proceed to wind up the corporate affairs under directions of the court. (Record pages 72 to 79 inc.) The Record also sets out the decision of the Judge upon which the order of foreclosure was entered. (Record pages 80 to 96, inc.)

On April 16th, 1942, before sale could be had of the real estate upon the order of foreclosure, petitioner filed a voluntary petition in bankruptcy in the District Court of the United States for the Southern District of Ohio and on the same day, the bankruptcy court entered an adjudication of bankruptcy, order of reference and a re-

straining order enjoining further proceedings in the Common Pleas Court.

On April 23rd, 1942, respondents filed a motion in the bankruptcy proceeding for an order of dissolution of the restraining order issued by the bankruptcy court. (While the motion embraced other matters than the dissolution of the restraining order, only the action of the District Court and the Circuit Court of Appeals upon the motion to dissolve the restraining order is the subject of review now before this Court.) See Record pages 99, 100 and 101.

The bankruptcy court overruled the motion to dissolve the restraining order. An appeal was taken by the respondents to the United States Circuit Court of Appeals for the Sixth Circuit. The Circuit Court of Appeals reversed the District Court and remanded the cause with instructions to the District Court to sustain the motion to dissolve the restraining order.

This proceeding is prosecuted for the purpose of a review of the judgment of the United States Circuit Court of Appeals.

The only assets of the bankrupt involved in these proceedings are the respective tracts of real estate upon which the two Savings and Loan Associations were found to have had valid and existing mortgage liens which were ordered foreclosed and the real estate sold to satisfy the amounts found due on each mortgage. No judgments, or judgments for any deficiency, were rendered other than findings of the amounts due and the order of sale. Other assets than the real estate involved in the foreclosure proceedings are subject to disposition by the bankruptcy court and its trustee who was duly appointed in the bankruptcy proceeding.

LEGAL QUESTIONS INVOLVED

We believe that the legal question in this cause can be summarized thus:

> Where a State Court of competent jurisdiction has acquired custody of a res in a proceeding to foreclose specific mortgage liens which were in existence, and were ordered foreclosed in an action for that purpose, more than four months prior to the filing of a bankruptcy proceeding generally, does the jurisdiction of the bankruptcy court supersede that of the State Court so as to deprive the State Court of jurisdiction to proceed to a final disposition of the foreclosure proceedings: especially where the proceedings in the State Court had reached the stage of a final determination and decree of foreclosure and an order of sale? Under such circumstances, should a Court of Bankruptcy exercise or have the authority to enjoin further proceedings by the State Court?

ARGUMENT

It is the opinion of the respondents that the principle involved is one of comity between courts, rather than one of jurisdiction. We believe that it has been firmly settled by the Supreme Court of the United States, that as between two judicial tribunals of co-ordinate and concurrent jurisdiction, under circumstances such as the case now under consideration, that court which first acquires jurisdiction of a res, also acquires the right to proceed to a final conclusion without interruption, unless there is some positive requirement of law to the contrary. That where an action has been brought in a State Court of competent jurisdiction to enforce a specific lien which is not itself invalidated or avoided by bankruptcy, the subsequent institution of bankruptcy proceedings does not operate to suspend the proceedings in the State Court, nor de-

prive it of jurisdiction to proceed to a final disposition of the res actually in its custody; especially is this true where the proceeding to foreclose or enforce the lien is instituted more than four months prior to the filing of the bankruptcy proceeding.

As nearly as we can gather from the brief of the petitioner, it is contended that because the foreclosure proceeding in the State Court had not proceeded to a judgment and decree of foreclosure until within four months immediately preceding the filing of the voluntary petition in bankruptcy by the mortgagee, the bankrupt, that the judgment and decree of the State Court foreclosing the mortgage liens, constituted a "lien" acquired on the property of the bankrupt within the preferential four months' period invalidated by the bankruptcy act. While petitioner does not expressly so state, we infer that their reasoning is on the basis of a *merger* ex proprio vigore of the mortgage lien in the judgment and decree of the court. At least this cannot be true to invalidate liens which are not specifically invalidated by the Bankruptcy Act itself or by some other positive rule of law. Actually the validity and existence of the mortgage liens themselves have never been in controversy, and even if they had been the judgment and decree of the State Court became final and conclusive and is entitled to full faith and credit and not subject to collateral attack. Independent, however, of the judgment and decree of the State Court, the liens held by the mortgagees upon the various tracts of real estate are liens by virtue of the mortgages and were not liens created by the court or the proceeding in which the court rendered judgment of foreclosure.

It also appears to be urged by the petitioner that be-

cause bankruptcy intervened before a sale could be had under the decree of the court, that bankruptcy obliterated all the proceedings and decrees of the State Court and opened up the entire subject matter to an adjudication de novo by the bankruptcy court.

Such conclusions we believe are erroneously conceived by the petitioner for two cogent reasons, viz:

1. If the rules of law pertaining to comity and conflict of jurisdiction between co-ordinate courts, in the matter of adjustment of conflicting jurisdiction, are to be confined exclusively to only those judicial proceedings which reach a final and complete stage of procedure before the intervention of bankruptcy, there could be no reason or occasion for the existence of that body of administrative law.

2. Petitioner fails to make distinction between liens created or the result of judicial proceedings, and proceedings to enforce liens which were acquired independently of judicial proceedings and in existence more than four months next preceding the bankruptcy.

At this stage, it seems proper to inform the court that in the State of Ohio, mortgage liens upon real estate are created through an instrument in the form of the ordinary common law warranty deed of bargain and sale, with a defeasance clause or condition subsequent, providing that the conveyance shall become void upon the performance of a specified condition, usually the payment of money, as in the case at bar, but not necessarily so. By statutory law, such instruments are required to be recorded in public records of the County wherein the lands are situate, and are effective as liens from the time of such record until barred by limitation, or the condition has been discharged by the mortgagor or his successors in interest and estate. By judicial construction, the mortgagee is

deemed vested of the legal title and the mortgagor to hold "an equity of redemption" in the lands. The remedies of the mortgagee are two; sale under judicial foreclosure proceedings which cut off the equity of redemption, and ejectment which does not cut off the equity of redemption which continues until barred by statutory limitation. The latter remedy is rarely resorted to. In the instant case, the Common Pleas Court proceeded to a foreclosure upon the cross-petition of the mortgagees, respondents herein, praying for that affirmative relief. (Record bottom page 80, top page 81 and Decree of Court, Record page 78). The mortgages and liens of the two Savings and Loan Associations were in existence at and prior to the time when proceedings were first instituted in the State Court, May 8th, 1933, (Record page 82 and 83). All of them had been duly recorded.

It is also urged by petitioner, without assigning any specific reason for the conclusion, that by reason of inaction of the Court of Common Pleas from March, 1939 to June, 1941, that the mortgage liens became "dormant" and were only revivified by the decree of the court in March, 1942. No reference, however, is made to the fact that this is the period in which a petition for reorganization under The Chandler Act was pending and further procedure by the State Court in foreclosure had been enjoined by the Bankruptcy Court. Such a contention is manifestly without legal foundation.

Without quoting at length, we respectfully refer the Court to Volume 5 of Remington on Bankruptcy, Fourth Edition, Section 2042, page 96, § 2067, page 139, § 2070, page 141 and § 2103, page 190. Summarizing the text of the author quoted, it is stated that a State Court first ob-

taining the possession of property, afterward claimed through bankruptcy proceedings, retains jurisdiction to the end, with but three exceptions: viz; where possession by the State Court creates a lien by the proceedings within the four months' period; where the proceedings in the State Court are tantamount to bankrutcy or insolvency proceedings; and where the proceedings in the State Court involve a receivership, assignment for the benefit of creditors or similar proceeding, created within four months next preceding the filing of the bankruptcy proceeding. An action in foreclosure, or to enforce a lien not created by the action itself and that is not in contravention of the peculiar provisions of the bankruptcy act nullifying liens obtained by legal proceedings or constituting a preference avoided by the Act, is not an action abated by the bankruptcy proceeding whether instituted within the four months' period or not. The same view of the law is stated in Collier on Bankruptcy, Fourteenth Edition, Volume 1, page 304, and Note 19 on page 308. Such has been the decision of this Court, as we construe it, and as interpreted by the Circuit Court of Appeals in the case of

Stratton v. *New,* 283 U. S. 318.

This Court has recently reaffirmed *Stratton* v. *New* in the recent case of

Emil v. *Hanley, Supreme* Court Law Edition
Advance Opinions Volume 87, page 643
Supreme Court Reporter, 687
U. S. Law Week, 4248.

At the time of the writing of this brief, we are not able to cite the official reports of this court. Both these cases affirm the right of the State Court to proceed to a con-

clusion of the foreclosure proceedings notwithstanding the filing of the bankruptcy petition or the adjudication of bankruptcy.

We believe it might have been maintained that the entire receivership proceedings in the State Court had a right to continue, but that question has never been advanced or presented by respondents nor do we now propound it. Respondents rely wholly upon the proposition that the proceedings of the State Court upon the application of the mortgagees on their cross-petition for the affirmative relief of an order of foreclosure of their mortgages upon the tracts of real estate involved is a proceeding, upon the authority of the decisions of this Court, which had and has the right under the principles of comity, to proceed without interference and to a final conclusion, notwithstanding the bankruptcy proceeding and that the District Court as a Court of Bankruptcy erred in issuing a restraining order enjoining further procedure in the State Court upon the foreclosure proceedings and in refusing to dissolve the injunction by the overruling of our motion to dissolve the same. That the Circuit Court of Appeals correctly decreed that the restraining order be dissolved and that the State Court and the respondents, the Merchants and Mechanics Federal Savings and Loan Association and the Springfield Federal Savings and Loan Association, have the right to proceed with the foreclosure of their mortgages and the sale of the real estate upon which they hold their mortgage liens, notwithstanding the bankruptcy. The Court will note that the foreclosure proceeding was a separate or separable proceeding for affirmative relief upon the cross-petition of the respondents specifically seeking foreclosure of their mortgages, and irrespective of the petition of the receiver to sell assets of the corporation. And it was so

treated by the trial court (Record bottom page 80, top page 81) which we quote herewith:

> "As the court summarized the issues, there are only two involved or to be determined. The first of these is whether or not the two Savings and Loan Associations hold valid mortgage liens upon the various tracts of real estate, and if so, the amounts of each of the mortgage debts secured thereby, the state of the lien of the mortgage as to priority, the conditions and terms of the mortgages and whether or not, aside from special considerations, the mortgagees are entitled to have their mortgages foreclosed and the properties sold and the proceeds applied to the satisfaction of the mortgage debts. Incidental to this issue, are the matters and rights of other parties defendant as regards liens or other interests which may appear to be necessary to be determined in connection with the title of the defendant corporation and interests to be sold, in the event a sale is found to be necessary."

The Court will further note that in the judgment entry following the Court's decision entered March 16th, 1942 (Record page 78) the foreclosure of the mortgage liens is ordered as a separate and distinct part of the decree, entirely severable from the direction of the Court to the receiver as to disposition of other assets and the future course of the receivership. Such procedure upon the part of the State Court does not infringe upon any of the provinces of the Bankruptcy Court. Under the circumstances, the only right or interest of the proceedings in bankruptcy are, and should be confined to, the turning over to the trustee in bankruptcy upon proper application or direction of any surplus that may remain from the sale of the mortgaged real estate after the satisfaction of the respective mortgages.

In conclusion, may we not also call the Court's attention to the fact that the Record discloses (pages 39, 40 and 41) that a large number of other individuals were made parties defendant to the foreclosure proceedings for the adjudication of various interests in the same real estate upon which the mortgage liens existed. Manifestly the numerous, necessary and proper parties to a complete determination and the clearing of the title to the real estate involved, rendered the State Court proceedings peculiarly adapted and fitted from an equitable standpoint, and manifestly to the benefit and not the detriment of all parties having an interest in the bankrupt's estate. It would seem that under the circumstances, a Court of Bankruptcy should have been hesitant to interfere. Certainly no advantage or benefit could be secured by the interruption or suspension of the proceedings in the State Court to the accrual of other creditors whose rights and interests cannot be enlarged by the bankruptcy proceeding. There is no question of a preference invalidated by the bankruptcy proceeding involved. The order of preference and priority in distribution of the proceeds would remain the same; they are concluded by the proceedings in the State Court.

Respectfully submitted,

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Roscoe C. Lorentz,
Attorneys for Respondents.